"FUTURE EFFECTS OF THE U.S. SUGAR PROGRAM – IMPACT ON PRODUCER COOPERATIVES"

Rick Dorn
Chairman of the Board
Rocky Mountain Sugar Growers Cooperative
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Introduction/Background

Thank you for the opportunity to participate in this Outlook Forum to discuss the future effects of the U.S. sugar program and its impact on producer cooperatives and producers attempting to form cooperatives. Let us begin by taking a look at an industry that is in rapid transition to a vertically integrated industry through farmer-owned cooperatives.

The cooperative effort began almost 30 years ago at the American Crystal Sugar Company in the Red River Valley of Minnesota/North Dakota. Two other cooperatively-owned factories were built in the mid-seventies at Minn-Dak Farmers Cooperative and Southern Minnesota Beet Sugar Cooperative. In the late 1990s, growers purchased the Amalgamated Sugar Company's four factories, and a new factory has been built in Moses Lake, Washington by local growers. Fifteen of the 28 beet factories in the U.S. were owned by growers last year, and produced sixty-five percent of last year's crop.

In 2002, another major shift to grower ownership will occur. We expect that 11 of the remaining 16 stock-owned beet factories in the U.S. will be purchased by their growers. For the 2002 crop, this would mean that 23 of the 28 beet factories will produce 85% of our nation's sugarbeet crop.

The five remaining factories--one in Michigan, one in Montana, one in Wyoming, and two in California) will be held by two companies. Four of the five are owned by Imperial Holly, which has sold or is in the process of selling its factories in Michigan and in Worland, Wyoming. Monitor Sugar in Michigan and Holly Sugar in Torrington, Wyoming compete with the neighboring cooperatives for some of the same growers.

So the question becomes, "Can a stock-owned company compete effectively in an industry that is predominately cooperatively-owned?" Only time will tell, but I personally believe that it will be difficult. It is also important to point out that vertical integration has also occurred on the cane side, with the purchase of Domino, Refined Sugars Incorporated, U.S. Sugar's cane refinery, and some raw mills that are looking at adding white ends onto their raw mills. The entire industry has been in a huge transition.

In order to evaluate the effect of the new sugar provisions on the industry, let us begin with the events of the last three years. One simple but major problem threatened the entire sugar industry--drastically low sugar prices resulting in unacceptable returns to producers. The causes of this problem were based on three factors.

First, guaranteed minimum import access under our WTO and NAFTA trade agreements. We have to import this sugar whether we need it or not. Second, the circumvention of the tariff rate quota by stuffed molasses. And third, expanded domestic production in order to lower production costs and maximize efficiencies. In the end, the market was simply oversupplied. An oversupplied market and severely depressed prices accelerated the pace of transition in the domestic sugar industry. Inadequate returns on both the farm and factory balance sheets forced growers and processors to seriously evaluate their traditional positions in this industry. From a growers' perspective, we wanted to preserve this important industry to provide an alternative value- added cropping option.

Solutions to the Problem

Now let us look at how the new sugar policy provides the essential elements for sustaining a domestic sugar industry. The various components of the new provisions provide for different “abilities” that we need to be successful in the sugar business.

Profitability is the foundation of any business. Profitability is achieved by maximizing income and reducing costs. Since there are no government transfers of income support to our producers, we have to--and want to--get our income from the marketplace. We cannot sustain the processor side of the equation with only income transfers to the producers. That is why traditional farm programs do not work in sugar. The only way we can get adequate income from the market is if the market is in balance.

Our industry’s objective in drafting recommendations for a new sugar policy was to get the market in balance and then keep it in balance. We applaud the Payment-In-Kind programs implemented by both the Clinton and Bush Administrations and the closure of the stuffed molasses import loophole by the courts helped restore balance in the market. The marketing allotments under the new farm bill will keep it in balance. The elimination of the burdensome and anti-competitive marketing assessment and the discriminatory forfeiture penalty in the new farm bill will help strengthen a minimal price safety net for our producers.

The fact is that there is no loan rate increase in the farm bill, and inflation continues to erode its real value, forcing the industry to find ways to reduce costs. On the cost- reduction side of the profitability equation, the new sugar provisions, coupled with the transition to farmer-owned companies, do several things.

First, it assures adequate acres and production to run the factory efficiently. Perhaps the greatest threat to stock companies, and their reason for exiting the business, is the lack of adequate production of beets for the factory. Since sugarbeets are a bulky and perishable specialty crop, a processor is limited to the production in the immediate vicinity of the factory. Stock companies must contract beets every year. While the provisions of the grower-processor contract may not change for multiple years, there is no obligation on the individual growers to produce the crop in any given year. Without an adequate acreage base and maximized factory throughput, the per-unit fixed cost increases significantly. Farmer owned cooperatives guarantee adequate acreage for efficient production.

Second, it removes the outside investor, which is a potential drain of cash from the growers, and secures grower control in reinvestment in the business through steady and adequate capital investments.

Third, when growers own their processing facilities, there is greater incentive for farmers to reduce costs on the farm and in the factory by making slight modifications in payment bonuses and penalties and seek other operational efficiencies.

Fourth, we have seen the synergies that can be created and the costs reduced in marketing our product.

Fifth, we anxiously await customer acceptance of sugar from biotech seed. Government and industry must continue to work aggressively to gain global consumer acceptance of this technology, and in doing so can help us further reduce our costs.

Predictability is essential for both producer and lender confidence. A farm bill that is in place for at least 5 years does provide the predictability we need as grower-owners. As bankers help our growers transition to factory ownership, the lenders need assurances that risks that may threaten the ability to service debt and pay principle are substantially reduced. It takes 5 to 10 years of good crops at profitable prices to complete the transition and put the company on a sound and strong economic foundation. Predictability is also important because of the two-year investment /return cycle required for growers of sugarbeets.

Flexibility is required in a changing and dynamic industry. While marketing allotments may keep the market in balance, the sugar provisions are extremely flexible to allow companies to enter and exit the business, as well as address virtually any reconfiguration of companies to adjust to market forces. In fact, they may be removed on an annual basis if imports are above our current minimum WTO and NAFTA import commitments.

Stability is essential to growers, processors and our customers. Huge swings in prices harm both producers and consumers. The new bill provides growers with a price safety net if sugar prices should ever plunge in the future. The ability to increase imports if prices significantly increase puts a cap on prices, which is the built in protection of the consumer.

Reliability as suppliers to the market has become more important in recent years. The farm bill also helps in this area. Advances in technology have allowed us to provide just-in-time deliveries to our customers. This has shifted the burden of inventory costs from our customers back to our producers. Storage of refined sugar is expensive. The lack of adequate storage has forced sugar onto the market, harming growers and causing forfeitures to the government. The new farm bill will allow us to get government loans to build more storage to assure that we bring sugar to the market in a more orderly manner.

Accountability for the proper operation of the program is at the heart of the new provisions. The Administration now has the tools to balance the market, and the clear mandate from Congress is to run the program at no cost. Industry is also held accountable to assure the delicate balance of supply and demand, or they, not the government, will be required to store sugar at their expense that will take up valuable storage space and overhang and depress the market.

In conclusion, the new sugar provisions have provided viability for efficient American sugar farmers to succeed in a world filled with unfair and predatory trade practices. As farmers, we have pooled our individual resources and collectively accepted the risks before us, and we will succeed.

Thank you.